National Committee to Preserve Social Security and Medicare

White Paper

The Impact of Social Security Privatization on the Disability Program

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THE IMPACT OF SOCIAL SECURITY PRIVATIZATION ON THE DISABILITY PROGRAM

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~Executive Summary~

Most of the public debate over restructuring Social Security has focused primarily on the retirement portion of the program. There has been much less attention given to the survivor or disability portions of the program, and how they could be affected by partial privatization. This paper examines specifically how privatization might affect the disability program. It examines the finances of the disability program, the demographics of its beneficiaries, and the likely impact of partial privatization on the program's future. The paper finds that:

- Treated separately, the disability program is projected to be in worse financial condition than the old age and survivors insurance portion of Social Security. The projected shortfall in the disability program over its seventy-five year planning horizon is 19.6 percent of projected income. By contrast, the projected shortfall in the OASI program is just 13.2 percent of projected income. The shortfall is also projected to occur earlier. The DI trust fund is projected to be depleted by 2023, whereas the OASI trust fund is projected to be solvent until 2039.

- Partial privatization of the OASI program is likely to force changes in the DI program as well:

  1) Both programs currently use the same formula for computing benefits. It would be unlikely that the formula used to calculate the OASI benefit would be altered to reduce benefits, with the DI formula remaining untouched indefinitely.

  2) If workers must rely on accumulation in their individual accounts to offset a reduction in the guaranteed OASI benefit, workers who have spent a significant period of time collecting DI benefits are unlikely to have accumulated enough in their accounts to offset the cuts in the guaranteed benefit.

  3) Raising the retirement age, which is often considered as part of privatization plans, would substantially increase the costs of the DI program increasing its projected shortfall. Workers who are already disabled at the current normal retirement age (NRA) are likely to remain on disability until they reach the new higher NRA. Also, workers who may have otherwise retired early may instead seek DI benefits since the early retirement benefits will also be reduced if the NRA is raised.

  4) The reduction in the size of the OASI program will lessen the efficiency of the combined program. The size of the administrative expenses is largely independent of the benefits provided. If the OASI program shrinks, the costs as a share of benefits will therefore rise. Since disability is the more costly portion of the two programs, this could lead to pressure to reduce costs or privatize the DI program. Of course, even with reduced efficiency, the DI program would still be far cheaper to operate than insurance programs in the private sector.

- More than one-fifth of all adult women and more than one quarter of adult men will receive DI benefits at some point in their lives.

- The DI program disproportionately benefits African-Americans. Adjusting for age, they are more than 70 percent more likely to receive benefits than whites. Also, the progressive benefit structure gives African-Americans a higher average benefit relative to wages than the benefit received by disabled white workers.

THE IMPACT OF SOCIAL SECURITY PRIVATIZATION ON THE DISABILITY PROGRAM

Dr. Dean Baker
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The public debate over restructuring Social Security has focused primarily on the retirement portion of the program. The other aspects of the system, its survivor and disability benefits, have generally received much less attention. The survivor and disability programs are considerably smaller than the retirement program, but still affect a very large segment of the population. In 1999 there were almost 7 million people receiving Social Security survivor benefits and more than 6.5 million people were receiving disability benefits (Social Security Administration [SSA]2000(a), pp 159, 164).

Most Social Security privatization proposals either ignore these parts of the program altogether, or imply that the current system of benefits will not be affected by changes in the retirement program. In fact, it cannot be assumed that it will be possible to restructure the retirement portion of the Social Security system without affecting the rest of the program. This paper examines the potential effect of a partial privatization of the retirement system on the disability program.

The first part of the paper describes the disability program in some detail. It includes a brief analysis of the financial state of the disability program and presents a breakdown of the beneficiaries by race, gender, and age. The second part of the paper examines the way in which a partial privatization of the retirement program is likely to affect the disability program. A brief conclusion summarizes some of the main points.

SOCIAL SECURITY DISABILITY INSURANCE: WHAT IT IS AND WHO GETS IT

The Social Security disability program is administered jointly with the retirement and survivors program, although it is financed by a separate designated tax. This tax is currently set at 1.8 percent of covered payroll, split evenly between the employer and employee. The disability program also collects a small amount of revenue from the portion of disability benefits subject to income taxes.[1] This amount is currently equal to approximately 0.02 percent of covered payroll. As with Social Security, the excess of current income over expenditures is placed into a trust fund that holds special issue government bonds. The interest on these bonds is a third source of income for the program. The Disability trust fund is projected to have a balance of approximately $120 billion at the end of 2000, which is expected to generate approximately $8.6 billion in interest for the fund in 2001 (SSA 2000(a), p101).

The benefit for disabled workers, and qualified spouses and children, is linked to the worker's earnings history by the same progressive formula used to determine retirement benefits. In 2000, a disabled worker's primary insurance amount (PIA) was equal to 90 percent of his or her first $531 of average indexed monthly earnings (AIME), 32 percent of the amount between $531 and $3,202, and 15 percent of the amount in excess of $3,202 (SSA 2000(a),

[1] The vast majority of disability benefits are not subject to income tax, but for middle and higher income individuals, disability benefits become subject to income tax according to the same formula used for OASI benefits. Since relatively few families with disabled workers reach these income thresholds, the amount collected in taxes on DI benefits is relatively small.

p69).[2] These bend points are indexed to the change in the average wage. For example, after 10 years the first bend point will be approximately 10 percent higher, after adjusting for inflation (assuming 1.0 percent annual real wage growth), so that a disabled worker first qualifying for benefits in 2010 will receive 90 percent of their first $584 in AIME (measured in year 2000 dollars). Once a worker begins receiving disability payments, the benefits are indexed to the consumer price index. This means that a disabled worker's benefit will typically be higher the later in life he or she qualifies for disability insurance (DI). This is both because workers' wages tend to rise over most of their working career, so that their average earnings will be higher relative to the rest of the workforce, and because the average wage in the economy tends to rise through time as well. A disabled worker receives an additional amount equal to 50 percent of the PIA for each child under age 18, and/or spouse that provides care for the worker or child, subject to a maximum benefit that is derived from the PIA. Disabled workers lose their benefits if the condition that led to their disability improves, they reach normal retirement age (at which point they receive OASI benefits), or they die.

The joint administration of the two programs allows for considerable economies, since both programs can rely on the same set of earnings records. The administrative expenses attributed to the Disability program in 2000 were estimated at $1.5 billion (SSA 2000(a), p 45). This compares to estimated administrative expenses of $1.8 billion for the Old-Age and Survivors Insurance (OASI) portion of the program (SSA 2000(a), p 39). The administrative expenses of the DI program are considerably higher when measured relative to benefits than with the OASI program, being equal to approximately 3.0 percent of benefits compared to just 0.6 percent in the case of the OASI program. The main reason for the higher cost of administering the DI program is the difficulties associated with making a determination of disability. This determination also must be verified at subsequent points if the worker continues to receive disability benefits. The criteria for qualifying for OASI benefits are less ambiguous and do not generally require any further verification once an individual has been determined to be eligible to collect benefits. Even with its higher costs, the administrative fees of running the DI program are still less than 20 percent of the administrative fees charged by private insurers which average 17 percent (American Council of Life Insurance 1997, p 42).[3]

The projected financial status of the DI program is actually considerably worse than for the OASI program. The projected shortfall for the DI program over the fund's 75-year planning horizon is equal to 0.37 percent of payroll. This projected shortfall is equal to 19.6 percent of the DI trust fund's projected income over the period. By comparison, the OASI fund's projected shortfall is equal to 1.53 percent of payroll, an amount equal to 13.2 percent of its projected income over the next seventy five years (SSA 2000(a), p 113). While the OASI fund would be fully solvent until 2039 in the latest projections, the DI fund would be depleted by 2023. Table 1 shows a summary of the projected income and cost rates for the two programs in the intermediate scenario in the 2000 Trustees Report.

As can be seen, most of the projected shortfall in the combined OASDI program is attributable to the projected shortfall in the OASI program, however the DI program is projected to contribute disproportionately to the deficit. This is especially true over the mid-term period, where the DI program is projected to account for more than one quarter of the shortfall that is projected for the combined program over the next 50 years. This point is worth noting, since the DI program clearly appears somewhat less healthy on its own than the combined OASDI program.

It is also worth noting the timing of the projected shortfalls in the DI program. The demographics that pose a long-term problem for the OASI pro-

[2] The AIME is calculated based on the worker's average annual earnings since turning age 21. Depending on the workers age, some number of low earning years will be excluded from the calculation, leaving only the worker's higher earning years. A full description of the formula for calculating benefits can be found in SSA 2000(b).

[3]This calculation takes all expenses of operating life insurance companies, including taxes and dividend payments and divides it by benefits paid to shareholders plus additions to reserves. These expenses include those associated with both standard life insurance policies and disability policies offered by the industry. Since the cost of administering standard life insurance policies are almost certainly lower than the cost of administering disability policies, this figure probably understates the cost of administering disability policies in the private sector.

gram affect the DI program in a slightly different pattern. Table 2 shows the annual projected income and costs for the two programs over the next decade and five year averages for the rest of the projection period. The most rapid increase in costs in the DI program take place over the next decade, as the baby boom generation begins to reach the peak years of disability, the early fifties until retirement. This effect is compounded by the raising of the normal retirement age from 65 to 66 over this period, which adds another year in which disabled workers will receive DI benefits rather than OASI benefits.

After 2010, the projected rate of increase in the cost of the DI program levels off, as the percentage of the workforce in the peak disability years grows more slowly. The main factor leading to the rise in costs shown from 2015 to 2025 is the phase-in of the increase in the normal retirement age to 67, which again adds an additional year of DI benefits for many workers. After the year 2025, the increases in cost are relatively modest as the working age population is projected to gradually increase in age so that a larger portion occupy the high disability age groupings.

There is one last point about DI projections that bears mentioning. These figures are even more uncertain than the projections for OASI because there are several additional factors that can have significant effects on cost projections. For example, the onset of a serious epidemic, such as AIDS, can add hundreds of thousands of people to the disability rolls. The life expectancy and general health of these workers will also affect the amount of time that workers receive disability, since they may either die, if a disease cannot be effectively treated, or return to work if the disease can be cured or at least controlled. Similarly, the health and safety of the work environment can have a large effect on disability rates. This includes not only the physical conditions of work but also factors such as stress since approximately one quarter of the workers receiving DI benefits suffer from mental disabilities.[4] Finally the standards that are applied to determine disability can change as a result of policy decisions. For example, in 1997, alcoholism and drug addiction were eliminated from the lists of disabilities that qualified for DI benefits. More rigorous standards in determining initial disability and more extensive verification procedures for workers already receiving benefits can also reduce the number of people receiving DI benefits.

For these reasons, the percentage of the workforce receiving DI benefits has been subject to large and unpredicted fluctuations. From 1970 to 1980, the percentage of covered workers receiving disability benefits rose from 2.76 percent to 4.17 percent. This increase took place even as the work force was getting younger due to the entrance of a large number of baby boomers. In the next decade, the percentage of beneficiaries fell back to 3.14 percent in 1990. It then jumped again to 4.06 percent in 1995. The percentage of DI beneficiaries among covered workers has continued to increase more modestly in the last four years to 4.24 percent in 1999 (SSA 2000, p122). These large variations in disability rates over the last three decades provide considerable grounds for caution when evaluating current projections for the future cost of the program.

BENEFICIARIES BY AGE DISTRIBUTION

The population of workers receiving DI benefits is disproportionately comprised of older workers and men. Table 3 shows the number of DI beneficiaries in 1999 by age and race.[5] As the table indicates, incidences of disability are relatively rare among younger workers. Less than 3 percent of the workers receiving DI benefits are under age 30. By contrast, nearly 60 percent of beneficiaries are over age 50, and 22 percent are over age 60. Most of the 4.9 million disabled workers receiving benefits are white, but African-American workers receive benefits in disproportionate numbers.

This can be seen more clearly in Table 4, which shows the percentage of whites and African-Americans in various age groupings who were receiving disability benefits in 1999. The disability rates for African-Americans are on average 55.5 percent higher than for whites. This ratio varies somewhat by age, with the ratio of disability among African-Americans to whites peaking at just under 2 to 1, for the 50-54 age group. At older ages, the ra-

[4] In 1999, 27 percent of DI beneficiaries were classified as having mental disorders. Musculoskeletal conditions were the next leading cause of disability, at 22 percent of beneficiaries. This is followed by circulatory conditions, 12 percent, and nervous system disorders, 10 percent (SSA 2000 (b), p 167).

[5] The "other" category in this table is ill-defined. It includes people who identify themselves as Asian and Pacific Islanders, Native Americans, and a subset of beneficiaries of Hispanic origin.

tio falls back slightly as the percentage of whites receiving disability rises more rapidly than the percentage of African-Americans. It is worth noting that the overall averages understate somewhat the extent to which African-Americans disproportionately benefit from disability, since the African-American population is considerably younger on average than the white population. This is due to the fact that African-Americans have somewhat higher birth rates and considerably lower life expectancies. If the age distribution for African-Americans were the same as for whites, the percentage of DI beneficiaries among African-Americans would be more than 70 percent higher than for whites. While the DI program is an important form of insurance for all workers, it is clearly more important for African-Americans than for the population as a whole.

Table 5 presents a slightly different perspective on the age distribution of the population of DI beneficiaries. It shows projections for the percentage of men and women in the 1965 birth cohort who will be receiving DI benefits at each age.[6] At ages 21 and 25, the probabilities that a worker will be receiving benefits are well below 1.0 percent for both men and women. The probability that a worker is receiving benefits is projected to stay relatively low into the mid-forties, at which point 3.7 percent of men and 3.2 percent of women are projected to be receiving benefits. However, it rises rapidly as workers enter their fifties, with 8.0 percent of the men and 7.4 percent of the women in this age cohort projected to be receiving DI benefits at age 55. By age 65, the projected percentages are up to 16.2 and 14.5 percent, for men and women, respectively.

One reason why the frequency of DI benefits rises so much with age is that workers rarely leave disability once they qualify for benefits, except through death. Typically, the termination rate of benefits for reasons other than death is just 1 percent a year (Zayatz, 1999). The current rules make it relatively difficult to be judged eligible for disability. They require that the worker's condition make him or her unable to engage in substantial gainful employment (defined as earning more than $700 per month). The worker must be continually disabled for at least five months before qualifying for benefits, and the condition must be expected to last at least 12 months or lead to death. In principle, these are quite stringent conditions that necessitate a seriously disabling injury or disease. Furthermore, there is no possibility of collecting partial benefits. This means that once a worker is classified as disabled there is little incentive to find part-time employment that may be possible even with the disability. Also, a worker suffering from a serious disease, such as cancer, would be taking a large risk if he or she voluntarily ended DI benefits during a period of remission, only to have the disease return.

Table 6 shows that projected probability that a worker from the 1965 age cohort, will at some point in his or her life be receiving DI benefits, given that they are alive at ages shown in the table.[7] These figures can be seen as simple measure of the importance of the program to the working population. As the table indicates, 22.9 percent of the women from this age cohort, who are alive at age 25, can expect to receive disability benefits at some point in their lives. In the case of the men from this age cohort who are alive at age 25, 29.5 percent can expect to receive DI benefits at some point in their life. The data in the table indicate that a very large percentage of workers can expect to be dependent on DI benefits for at least some period of time.

Table 7 presents the breakdown of DI beneficiaries by age, race, and sex for 1999. It is worth noting that the ratio of male to female beneficiaries is not nearly as high among African-Americans as among whites. For whites the overall ratio of men to women beneficiaries is 1.4 to 1. For African-Americans the ratio is just 1.19 to 1. The difference is even more pronounced for older beneficiaries. Among whites aged 60-64, the ratio of men to women beneficiaries is 1.54 to 1. For African-Americans in this age cohort the ratio is 1.08 to 1. The main reason for the lower ratio among African-Americans is the higher mortality rate among African-American men than among white men, which prevents many of them from reaching the years in which they have the highest probability of being disabled.

[6] The percentages shown in the table are of all members of this birth cohort who are expected to live to age 21. The most recent projections from the Social Security trustees show little change in disability rates by age, so the 1965 cohort is not projected to have a very different disability experience from earlier or later birth cohorts.

[7] The construction of this table is explained in the appendix.

Table 8 shows the average monthly benefit by age and race for disabled workers in 1999. The table shows the expected pattern, with older workers receiving considerably higher benefits on average than younger workers. The average monthly benefit of $820 dollars for workers between the ages of 60 to 64 is nearly twice the average benefit of $416 for workers between the ages of 20 to 24. It is worth noting that while there is a gap between the average monthly benefit received by white workers and African-Americans workers, it is not nearly as large as the wage gap between these two groups. The average monthly benefit for African-American workers is 90.3 percent of the average benefit for white workers. By comparison, the median hourly wage for black men was just 77.6 percent of the median wage for white men, and the median hourly wage for black women was 87.3 percent of the median hourly wage for white women (Mishel, Bernstein, and Schmitt, 2001, p 166). The reason for the smaller racial gap in average benefits is the progressivity of the benefit formula, which collapses differences in wages.

The gap is even smaller after controlling for age. For example, in the case of disabled workers between ages 50 to 54, the average benefit for African-Americans workers is 93.6 percent of the average benefit received by white workers. This ratio falls somewhat among older workers because the African-American beneficiaries become disproportionately women, as large numbers of men die. This lowers the average benefit for African-American workers since there is a large gap between the benefits received by men and women.

This issue is examined explicitly in Table 9. This table presents the average monthly benefit by race and sex. Overall the ratio of the average benefit received by women workers to men is 74.4 percent, slightly lower than the 76.9 percent ratio for the median hourly wages of women and men (Mishel, Bernstein, and Schmitt, 2000, p 128). In this case, the fact that most women will spend some period of time partially or completely outside of the paid labor force raising children offsets the progressivity of the benefit formula. These women end up having some years of zero or very low earnings included in the calculation of their disability benefits. At first glance, the gender gap appears to be considerable smaller for blacks, at 83.0 percent, than it is for all workers. However, a more careful examination shows that this is simply attributable to the greater concentration of African-American women beneficiaries in the higher age categories, which also receive higher benefits on average. African-American women between the ages of 60 to 64, receive on average, only 71.4 percent of the benefits received by African-American men in this wage group.

The disability insurance program also provides benefits to the children of disabled workers and spouses of disabled workers who stay home to care for children. Table 10 gives the racial breakdown of secondary beneficiaries in these categories. Overall, 176,700 spouses received disability benefits in 1999, while 1,475,600 children received benefits. African-American children received DI benefits in proportionately much greater numbers than white children. They accounted for 21.0 percent of the children receiving benefits.

Table 11 shows the average size of the secondary benefits by race. The average monthly benefit for spouses of disabled workers is $191. The average monthly benefit for the children of disabled workers is $216. It is important to remember that this benefit is per child so that a disabled worker with two children receiving the average benefit would be getting $432 per month to help support his or her children.[8]

THE IMPACT OF SOCIAL SECURITY PRIVATIZATION ON THE DISABILITY PROGRAM

As noted earlier, most of the plans for partially privatizing Social Security propose leaving the disability program in tact or ignore it altogether. The explicit or implicit assumption is that it will be possible to substantially change the OASI portion of the system without affecting the DI portion. There are at least four practical and/or political reasons for believing that this is not the case:

1) the benefit formulas for the two programs are currently identical, once the determination of average indexed monthly earnings has been made. If the formulas remain identical then a cut in the OASI portion of the program implies a cut in the DI portion as well. Congress could opt to leave the DI

[8] This benefit is subject to a maximum that is derived from the primary insurance amount. The formula can be found in SSA 2000(a) p 69.

benefit formula unchanged even as it changes the formula in a way that reduces the guaranteed benefit provided under the OASI program, but this seems unlikely. At the very least, partial privatization would make the DI benefit formula a topic for debate;

2) if workers are expected to gain a substantial portion of their retirement benefit from individual accounts, then workers who have spent many years outside of the work force receiving DI benefits will have accumulated little in these accounts and will have inadequate retirement benefits;

3) raising the retirement age, which is one of the cuts often proposed as part of a privatization package, will substantially increase the cost of the disability program since the oldest workers are the most likely to be receiving DI benefits;

4) as the OASI share of the program shrinks the rising percentage of the combined program being absorbed by administrative costs could become a political issue. While the administrative costs of the DI program are still very low compared to private sector alternatives, the differences will not be as great as at present when these expenses can be shared with a large OASI program. Each of these issues is discussed in turn below.

Adjusting the Benefit Formulas

As a matter of logic, separating the benefit formula for the DI program from OASI program should not be very difficult. It simply requires that Congress specify a new formula for the OASI benefit, which is distinct from the current DI formula. In other words, Congress would change the formula for calculating the retirement benefit in a way that lowers the guaranteed benefit provided under the program, while leaving the DI benefit formula unchanged.[9]

However, it seems politically unlikely that Congress would go this route. Insofar as the two programs are seen as a single entity, it might be hard to justify continually cutting back the benefit provided to retirees under the OASI program, while the DI benefits remain untouched. This is especially likely to be the case since virtually all workers will collect OASI benefits, if they live long enough to retire. While nearly all workers are covered by the insurance provided by the disability program, most workers will never actually receive DI benefits. Insofar as DI beneficiaries are seen as a special interest group (a perception which may be facilitated by the fact that the population of beneficiaries is disproportionately minority) cuts in DI benefits may prove to be a politically attractive alternative to deeper cuts in OASI benefits. The fact that the DI program is projected to be running at a deficit in just over a decade will also make it a more attractive target for benefit cuts.
It is worth noting that the most detailed proposal for partial privatization with benefit cuts, a plan put forward by the National Commission on Retirement Policy's (NCRP) in 1998, called for phasing in a set of cuts to DI benefits which were identical to the cuts proposed for the OASI program. For example, the plan called for reducing the annual cost of living adjustment by 0.5 percentage points for both DI and OASI benefits. It also proposed reducing the ratio of the monthly benefit to the AIME for all but the lowest paid workers. This reduction in benefits would apply to both workers receiving OASI and DI benefits. (A description of the main features of the NCRP plan can be found in SSA 1998.)

Even if a partial privatization of the OASI program did not set in place a schedule of cuts to the DI program, it still could lead to a situation in which cuts would be made in the future. For example, it is possible that limited privatization would be put in place at present with a commitment to re-examine the split between individual accounts and guaranteed benefits at some designated time in the future (e.g. ten years). This sort of half-way measure would virtually guarantee that the status of the DI program would also be a topic of debate at a future time. Even if the present intent of Congress were to leave the DI program in tact, this would not prevent a future Congress from substantially changing or cutting back the DI program if the structure of the OASI program is again put up for debate. In short, a congressional debate on the structure of the OASI program always raises the possibility of spilling over into a debate on the structure of the DI portion of the program as well. Their historical linkage makes it extremely difficult to try to keep the two programs separate in future public debates.

[9] It is worth noting that one implication of a cut in the OASI benefit, which is not accompanied by a cut in the DI benefit, is that workers who are receiving DI benefits at the time when they reach the normal retirement age will typically experience a large reduction in benefits when they switch over to OASI benefits.

The Adequacy of Retirement Benefits for the Disabled

The current benefit formula is structured so that the retirement benefit for disabled workers is not significantly reduced as a result of the worker's disability. The years that a worker is out of the workforce as a result of disability are removed from the 35 years used to compute a worker's average earnings. This means that the retirement benefit is only based on the worker's earning during the period of time when he or she is healthy.

This sort of formula could be left in place with a partially privatized system. However, under such a system it will typically provide a disabled worker with a much lower retirement benefit relative to that received by a worker who did not become disabled, since the disabled worker will not be making contributions to an individual account during the period in which he or she is disabled. If the earnings from the individual account provide a substantial portion of the total retirement benefit then disabled workers will experience large declines in retirement benefits relative to what is scheduled under the current system.

For example, after the full benefit reductions in NCRP plan are phased-in 2020, a retiree earning the average income would receive approximately 17 percent less at the point where they reach the normal retirement age (age 70 in 2029) than under current law.[10] Their benefit would be reduced by another 5.0 percent over the next five years because the annual cost-of-living adjustment is 0.5 percentage point less than under current law. The benefit reduction for people who live 20 years into retirement will be reduced by more than 25 percent compared with current law. The reduction will be even larger for workers, most often women, who spend several years outside of the paid labor force, since the NCRP plan calls for increasing the number of working years included in the average wage formula to 40 from the current 35. This will result in most workers including some years of little or no earnings in their average wage calculation. The most extreme privatization plan that came out of the 1994-96 Advisory Council, the Scheiber-Weaver Plan, called for reducing the core benefit for an average wage earner by 60 percent (Advisory Council, 1997). Several studies have shown that most workers will probably not be able to make up for cuts of this magnitude with the accumulations in their individual accounts (e.g. Baker, 1998; Meuller, 1999). But workers who have lost several years of contributions due to disability clearly will not be able to avoid large reductions in their retirement incomes if such plans are implemented.

[10] The NCRP plan will lower the PIA formula by one third at the second and third bend points. An average income retiree will derive approximately 52 percent of their benefit from income that is above the second or third bend point (SSA 2000(a) p 185).

The Impact of a Higher Retirement Age

As noted earlier, the normal retirement age (the age at which a worker can receive full scheduled benefits) is already scheduled to rise to 67 by 2027. However, many privatization plans calls for accelerating the scheduled increase in the normal retirement age (NRA) and/or raising it further. For example, as noted above, the NCRP plan would raise the NRA to age 70 by 2029. A proposal put forward in 1998 by then-Senators Patrick Moynihan and Robert Kerry would raise the NRA to 70 by 2065 (Moynihan, 1998). It is likely that some increase in the NRA would be included as part of any privatization plan.

Any further increases in the NRA will substantially raise the costs of the DI program for two reasons. First, workers are most likely to be receiving disability benefits in their last years before reaching the NRA. As shown in Table 5, current projections show that 14.7 percent of women and 16.2 percent of men will be receiving disability benefits at age 66 in 2031. This figure will be even higher if workers have to wait longer before collecting OASI benefits. Workers are joining the disability rolls at a very rapid rate during these years, while very few are leaving the rolls.[11] This means that a very large percentage of workers will be receiving DI benefits in the years added to the NRA.

The second reason that a higher NRA will increase the number of workers receiving DI is that it will discourage many workers from collecting early re-

[11] For people in the 1965 birth cohort, it is projected that at ages 65 and 66, respectively, 1.3 and 1.2 percent of men in this cohort will get added to the disability rolls. For women, the numbers are projected to be 0.9 and 0.7 percent. The recovery rates for workers at this age are less than 1.0 percent of the total number of workers on disability.

tirement benefits. Most workers start collecting reduced OASI benefits before they reach the NRA. Age 62, the first year of eligibility, is the year in which the largest percentage of workers begins to collect benefits. When the NRA is raised, there will be a larger reduction in benefits for those who opt to start receiving them early. This will discourage workers from retiring early, which is the intention. (The NCRP plan actually raises the first year of eligibility for OASI benefits to age 65.) While this will reduce the cost of the OASI portion of the program it will inevitably lead to more workers receiving DI benefits as people who may otherwise have been retired will find themselves disabled and therefore incapable of holding a job. Also, simply by increasing the relative attractiveness of DI benefits, more workers will try to qualify for them rather than receiving their lowered OASI benefit.

The combined impact of these two effects could lead to a substantial increase in the cost of the DI program. As noted before, the highest disability benefits are received by older workers, since they are likely to have a higher history of earnings and average wages in the economy rise through time. Therefore, shifting more workers in their mid and late sixties unto the DI rolls could prove to be rather expensive to the program. Since this expense is more than offset by the savings to OASI program, the combined program clearly saves money through an increase in the NRA. However, insofar as the two are viewed as discrete programs, this shifting will increase the projected shortfall in the DI program and could increase pressure to reduce benefits.

Administrative Expenses Under Partial Privatization

One of the great advantages of the existing system is that it allows for enormous economies of scale by combining the DI and OASI programs under a single administrative structure. It is not necessary to keep duplicate records on earnings histories and benefit payments. The administrative cost of the program is also largely unaffected by the size of the benefits paid out. This means that if benefits paid out by the OASI program are reduced as a result of a partial privatization plan the ratio of administrative costs to benefits will rise. This problem will be aggravated further if the privatization is coupled with an increase in the NRA. As noted above, this would increase the number of workers who receive DI benefits before qualifying for OASI benefits, thereby raising the cost of the DI program.

In principle, this should not create any significant problems for either the OASI program or the DI program. Even if the benefits paid out under the OASI program were cut in half, the administrative costs of the combined program would still be less than 2.0 percent of the benefits paid out each year. This is well below the 15-20 percent costs of operating insurance programs in the private sector (American Council of Life Insurance 1997, p 42).

However, if the DI program comes to be viewed as a distinct entity its higher administrative costs may become more of a political issue. While the program would still be considerably cheaper to operate than private systems, the gap would not be quite as large as it is with the combined OASDI program. This could cause some policy makers to look to replace all or part of the DI program with a privately-run system.

This possibility could be increased due to the fact that the beneficiaries of DI program are disproportionately poor and minorities. As the DI program grows in size relative to the OASI program, the DI portion of the program may come to be perceived as a distinct program. Furthermore, it may be regarded as a welfare program, rather than a universal social insurance program. This could leave it politically vulnerable to cuts.

CONCLUSION

The disability insurance program provides an important source of insurance for more than 140 million covered workers and their families. While most of these workers will never actually collect benefits under the disability program, nearly one sixth of all workers will collect benefits at some point in their life. The fact that the insurance exists is important to all covered, even if they never have to use it.

The DI program disproportionately benefits African-Americans and poorer workers. African-Americans are approximately 60 percent more likely to receive disability benefits than white workers. The program disproportionately benefits poorer workers both insofar as they may be more likely to get DI benefits, but also because the benefit structure is highly progressive. Lower income workers will receive a far higher benefit relative to their pre-disability earnings than higher income workers.

Partial privatization of Social Security OASI program will almost certainly lead to some cuts in the DI program. Several of the privatization programs that have been put forward explicitly call for cuts in DI benefits as well. However, even proposals that do not explicitly provide for cuts in the DI program are still likely to lead to reduced benefits. Since the formulas for the two programs are currently the same, it is unlikely that Congress will institute large cuts in the OASI benefit without also imposing cuts in DI benefits. Furthermore, raising the normal retirement age, which is a feature of many privatization plans, would significantly increase the costs of the DI program. Since the projected long-term financial situation of the DI program is already much worse than for the OASI program, any deterioration in its outlook as a result of a higher NRA will increase pressures to cut DI benefits. Also, as the OASI program shrinks due to partial privatization, the efficiency associated with operating a large single OASDI program will be reduced. This may also lead to more questions being raised about the structure of the program

There are few participants in the current debate over Social Security who do not recognize the importance of the disability insurance program in protecting workers against the financial impact of accidents or ill-health. At present this program enjoys widespread support. If it were not tied to the Old-Age and Survivors Insurance program there would probably be little interest in changing the Disability Insurance program. However, a move towards the privatization of the OASI portion of the program is almost certain to lead to cuts in the DI programs as well. This will disproportionately hurt some of the most vulnerable segments of the population.

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Table 1
Summary Income and Cost Projection for OASDI
Percent of Taxable Payroll

	OASI			DI			Combined		
	Income	Cost	Balance	Income	Cost	Balance	Income	Cost	Balance
25 years	11.94	10.8	1.14	1.94	2.04	-0.1	13.88	12.84	1.04
50 years	11.67	12.45	-0.77	1.9	2.18	-0.28	13.58	14.63	-1.06
75 years	11.62	13.15	-1.53	1.89	2.26	-0.37	13.51	15.4	-1.89

Source: SSA 2000(a) p113.

Table 2
Income and Cost Projections for OASDI
Percent of Taxable Payroll

	OASI			DI			Combined		
Year	Income	Cost	Balance	Income	Cost	Balance	Income	Cost	Balance
2000	10.83	8.91	1.92	1.82	1.42	0.39	12.65	10.33	2.31
2001	10.85	8.89	1.96	1.82	1.46	0.35	12.67	10.35	2.31
2002	10.85	8.91	1.94	1.82	1.51	0.3	12.67	10.42	2.24
2003	10.85	8.94	1.91	1.82	1.57	0.24	12.67	10.51	2.15
2004	10.86	8.98	1.88	1.82	1.64	0.18	12.68	10.62	2.06
2005	10.87	9.02	1.85	1.82	1.71	0.11	12.69	10.73	1.96
2006	10.87	9.09	1.78	1.82	1.79	0.04	12.69	10.88	1.82
2007	10.88	9.16	1.72	1.82	1.86	-0.04	12.7	11.02	1.68
2008	10.89	9.25	1.64	1.82	1.93	-0.1	12.71	11.18	1.54
2009	10.9	9.37	1.53	1.82	1.98	-0.16	12.72	11.35	1.37
2010	10.91	9.53	1.38	1.82	2.02	-0.2	12.73	11.55	1.18
2015	10.98	10.74	0.24	1.83	2.17	-0.34	12.81	12.91	-0.1
2020	11.08	12.4	-1.32	1.83	2.26	-0.43	12.91	14.66	-1.75
2025	11.17	13.86	-2.69	1.83	2.38	-0.55	13	16.24	-3.24
2030	11.25	14.94	-3.69	1.84	2.41	-0.57	13.09	17.35	-4.26
2035	11.3	15.48	-4.18	1.84	2.38	-0.54	13.14	17.86	-4.72
2040	11.32	15.46	-4.14	1.84	2.41	-0.57	13.16	17.87	-4.71
2045	11.34	15.35	-4.01	1.84	2.51	-0.67	13.18	17.86	-4.68
2050	11.36	15.4	-4.04	1.85	2.56	-0.71	13.21	17.96	-4.75
2055	11.39	15.67	-4.28	1.85	2.6	-0.75	13.24	18.27	-5.03
2060	11.42	16.04	-4.62	1.85	2.58	-0.73	13.27	18.62	-5.35
2065	11.45	16.36	-4.91	1.85	2.59	-0.74	13.3	18.95	-5.65
2070	11.47	16.63	-5.16	1.85	2.6	-0.75	13.32	19.23	-5.91
2075	11.49	16.89	-5.4	1.85	2.63	-0.78	13.34	19.52	-6.18

Source: SSA 2000(a) p 109.

Table 3
Demographics of DI Beneficiaries
Disabled Workers

Age	White	Black	Other	Total
Under 20	1,020	250	180	1,450
20-24	22,170	5,080	3,620	30,890
25-29	71,050	19,000	14,050	105,140
30-34	147,200	39,520.0	25,520	215,580
35-39	273,970	69,890.0	38,610	387,330
40-44	397,640	107,820.0	50,960	562,630
45-49	484,350	127,510.0	59,800	680,840
50-54	603,630	146,160.0	70,610	830,180
55-59	744,880	159,110.0	67,170	974,570
60-64	849,770	169,250.0	62,640	1,084,950
Total	3,595,680	843,590.0	393,160	4,873,560

Source: SSA 2000(b) table 5.A.1.

Table 4
Demographics of DI Beneficiaries
Percentage of Population Receiving Benefits

Age	White	Black
20-24	0.15%	0.18%
25-29	0.50%	0.73%
30-34	0.93%	1.49%
35-39	1.50%	2.41%
40-44	2.13%	3.83%
45-49	2.91%	5.48%
50-54	4.11%	8.08%
55-59	6.51%	11.95%
60-64	9.27%	15.58%
Total Working Age	2.69%	4.15%

Source: Social Security Annual Supplement, 2000 Table 5.A1 (www.ssa.gov/statistics/Supplement/2000/html/t5a1.htm) and United States Census Bureau, Projections of the Total Resident Population by 5-Year Age Groups, Race, and Hispanic Origin with Special Age Categories: Middle Series, 1999-2000. (www.census.gov/population/projections/nation/summary/np-t4-a.pdf)

Table 5
Probability of Receiving Disability Benefits
1965 Birth Cohort

Age	Male	Female
21	0.1	0.1
25	0.6	0.3
30	1.3	0.8
35	2.0	1.4
40	2.7	2.1
45	3.7	3.2
50	5.3	4.8
55	8.0	7.4
60	12.4	11.2
65	16.2	14.5

Source: Bakija and Steurele 1995.

Table 6
Probability of Receiving Benefits at Some Point
(1965 Birth Cohort)

Age	Male	Female
21	29.3	22.9
25	29.5	22.9
30	29.4	22.9
35	29.0	22.7
40	28.3	22.2
45	27.7	21.7
50	26.9	21.1
55	25.7	20.2
60	23.7	19.0
65	18.5	16.1

Source: Bakija and Steurele 1995 and author's calculations.

Table 7
Demographics of DI Beneficiaries
Disabled Workers

	White		Black		Other		Total	
	Men	Women	Men	Women	Men	Women	Men	Women
Under 20	590	430	130	120	110	70	830	620
20-24	13,070	9,100	2,910	2,170	2,320	1,300	18,300	12,570
25-29	41,070	29,980	10,940	8,060	8,360	5,690	60,370	43,730
30-34	84,760	62,440	23,550	15,970	15,630	9,890	123,940	88,300
35-39	159,160	114,810	40,880	29,010	22,720	15,890	222,760	159,710
40-44	229,230	168,410	62,390	45,430	29,650	21,310	321,270	235,150
45-49	277,390	206,960	69,210	58,300	33,420	26,380	380,020	291,640
50-54	343,040	260,590	78,540	67,620	39,800	30,810	461,380	359,020
55-59	432,080	312,800	82,110	77,000	35,230	31,940	549,420	421,740
60-64	515,820	333,950	88,060	81,190	34,620	28,020	638,500	443,160
Total	2,096,210	1,499,470	458,720	384,870	221,860	171,300	2,776,790	2,055,640

Source: Social Security Annual Supplement, 2000 Table 5.A1 (www.ssa.gov/statistics/Supplement/2000/html/t5a1.htm

Table 8
Demographics of DI Beneficiaries
Disabled Workers
Average Monthly Benefit

	White	Black	Other	Total
Under 20	$338	$336	$323	$336
20-24	$420	$410	$404	$416
25-29	$510	$482	$481	$501
30-34	$584	$550	$559	$575
35-39	$652	$589	$624	$637
40-44	$716	$653	$672	$700
45-49	$766	$711	$704	$751
50-54	$806	$755	$733	$791
55-59	$831	$756	$718	$811
60-64	$844	$741	$716	$820
Total	$776	$701	$681	$755

Source: Social Security Annual Supplement, 2000 Table 5.A1 (www.ssa.gov/statistics/Supplement/2000/html/t5a1.htm)

Table 9
Demographics of DI Beneficiaries
Average Monthly Benefit

	White		Black		Other		Total	
	Men	Women	Men	Women	Men	Women	Men	Women
Under 20	$320	$361	$382	$287	$276	$396	$324	$351
20-24	$432	$402	$425	$388	$407	$399	$428	$400
25-29	$524	$489	$491	$470	$495	$460	$514	$482
30-34	$597	$566	$555	$544	$571	$539	$586	$559
35-39	$674	$620	$599	$576	$640	$602	$656	$610
40-44	$764	$650	$674	$626	$711	$618	$741	$643
45-49	$841	$666	$750	$665	$776	$612	$819	$661
50-54	$917	$661	$821	$678	$828	$610	$893	$660
55-59	$973	$635	$856	$648	$840	$583	$947	$634
60-64	$987	$623	$859	$613	$831	$574	$961	$618
Total	$877	$634	$760	$631	$753	$589	$847	$630

Source: Social Security Annual Supplement, 2000 Table 5.A1 (www.ssa.gov/statistics/Supplement/2000/html/t5a1.htm

Table 10
Demographics of DI Beneficiaries
By Type of Beneficiary

	White	Black	Other	Total
Disabled Workers	3,595,680	843,590	393,160	4,873,560
Spouses	134,100	22,710	18,310	176,730
Children	983,020	310,230	168,210	1,475,580
under age 18	916,640	289,380	161,680	1,381,200
disabled -over 18	40,490	13,100	3,430	57,360
students aged 18-19	25,890	7,750	3,100	37,020
Total	4,712,800	1,176,530	579,680	6,525,870

Source: SSA 2000 (b) table 5.A.1.

Table 11
Demographics of DI Beneficiaries
By Type of Beneficiary
Average Monthly Benefit

	White	Black	Other	Total
Disabled Workers	$776	$701	$681	$755
Spouses	$200	$171	$149	$191
Children	$227	$203	$180	$216
under age 18	$219	$197	$176	$210
disabled -over 18	$325	$283	$259	$311
students aged 18-19	$334	$285	$273	$318

Source: Social Security Annual Supplement, 2000 Table 5.A1
(www.ssa.gov/statistics/Supplement/2000/html/t5a1.htm)

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Appendix

Tables 1 and 2 are constructed from data that can be found in the charts in SSA 2000(a) pages 109 and 113.

Table 3 uses data from SSA 2000(b) table 5.A1.

Table 4 uses data from SSA 2000(b) table 5.A1 for the number of beneficiaries by age and race. The data for the population of each group by age and race is taken from the 2000 U.S. government census projections.

Table 5 was constructed from the data in Bakija and Steurele, 1995, appendix tables A.11 and A.12.

Table 6 was constructed by summing the probability that an individual is alive and currently receiving DI benefits at age n, and the probability that he or she will qualify for disability benefits at some future point. The first part of this calculation is taken from Bakija and Steurele, 1995, appendix tables A.11 and A.12. The second part was calculated by summing the probability over the ages 66-n, that the individual will first qualify for disability. For any specific age, the probability that an individual will first qualify for benefits is given by P_S X $P_I (1- P_D - P_{PD})$, where P_S is the probability of surviving until age n, P_I is the probability among the exposed population of becoming disabled at age n, P_D is the probability of already being disabled at age n, and P_{PD} is the probability that a worker was previously disabled and again became disabled at age n. For simplicity it was assumed that the probability that a worker comes off disability and returns to the work force is 1.0 percent for all ages. This understates the probability for young workers and overstates it for older workers, however since the actual numbers involved are very small as a share of the workforce, this simplification is not likely to significantly affect the calculation. Also, it is assumed that a previously disabled worker is twice as likely to again become disabled as a worker that had never been disabled. This is a somewhat arbitrary assumption, but since the numbers of workers involved is small, plausible differences in this assumption would not significantly affect the numbers that appear in table 6. The data on incident rates and mortality rates were taken from tables A.1 and A.2 in Bakija and Stuerele 1995.

Table 7,8, 9, 10 and 11 rely on data from SSA 2000(b) table 5.A1.